

Message Text

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ACTION EUR-25

INFO OCT-01 ISO-00 SAJ-01 AID-20 CIAE-00 COME-00 EB-11

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FM AMEMBASSY LONDON

TO SECSTATE WASHDC 1213

INFO AMEMBASSY BONN

AMEMBASSY BRUSSELS

AMEMBASSY COPENHAGEN

AMEMBASSY DUBLIN

AMEMBASSY LUXEMBOURG

AMEMBASSY PARIS

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AMEMBASSY THE HAGUE

USMISSION EC BRUSSELS

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DEPARTMENT PASS TREASURY

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TAGS: ECON, UK

SUBJECT: NIESR CALLS FOR REFLATIONARY BUDGET AND INDEXA-
TION OF WAGES

REF: (A) A-513 OF JUNE 5, 1974; (B) A-373 OF APRIL 24,
1974; (C) LONDON 6560; (D) LONDON 6199

BEGIN SUMMARY: IN ITS MAY QUARTERLY BULLETIN, THE
NATIONAL INSTITUTE OF ECONOMIC AND SOCIAL RESEARCH (NIESR)
FORECAST NO GROWTH FOR THE BRITISH ECONOMY IN THE SECOND
HALF OF 1974 AND MINIMAL GROWTH IN 1975. IT CALLS FOR A
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REFLATIONARY BUDGET. DATA RELEASED IN THE PAST WEEK RE-

GARDING INVESTMENT INTENTIONS, INVENTORY DRAWDOWN DURING THE THREE-DAY POWER LIMIT, AND CONSUMER SPENDING, REINFORCE NIESR'S FORECAST. NIESR ALSO SUGGESTS INDEXING WAGES BUT ALLOWING NO REAL WAGE INCREASE OTHERWISE FOR THE NEXT TWO YEARS. WITH SUCH A STEP THE INSTITUTE BELIEVES THE UK INFLATION RATE COULD BE REDUCED TO 5 PERCENT IN 1976 (GIVEN STABILITY IN WORLD COMMODITY PRICES). WHETHER WAGE INDEXATION IS POLITICALLY PRACTICABLE, HOWEVER, IS DOUBTFUL. END SUMMARY

1. THE PRESTIGIOUS NIESR QUARTERLY FORECAST OF THE BRITISH ECONOMY, RELEASED MONDAY, JUNE 10, INDICATES REAL GDP AT FACTOR COST DECREASING BY 1 PERCENT IN 1974 AND INCREASING BY 1.9 PERCENT IN 1975. (FOURTH QUARTER AVERAGES OVER FOURTH QUARTER AVERAGES INDICATE A RISE OF 0.2 PERCENT IN 1974 AND 1.6 PERCENT IN 1975.) NIESR ESTIMATES CONSUMER EXPENDITURE WILL FALL BY 1.9 PERCENT THIS YEAR AND 0.4 PERCENT NEXT YEAR (MINUS 1.5 AND MINUS 0.9 IN 1974 AND 1975 RESPECTIVELY ON A FOURTH QUARTER AVERAGE BASIS). NIESR FORECASTS A DECREASE OF 2.0 PERCENT IN GROSS FIXED INVESTMENT THIS YEAR OVER LAST YEAR (MINUS 3.8 ON FOURTH QUARTER AVERAGES) AND FORESEES INVENTORY ACCUMULATION LOWER THAN 1973. INVESTMENT IN 1975 IS NOT FORESEEN AS STRONG EITHER. GROSS FIXED INVESTMENT IS SEEN AS INCREASING BY 2.8 PERCENT (6.4 PERCENT ON FOURTH QUARTER AVERAGES) WHILE INVENTORY ACCUMULATION REMAINS RATHER LEVEL THROUGHOUT THE YEAR, ONLY SLIGHTLY ABOVE 1974 AND WELL BELOW 1973.

2. THIS FORECAST IS IN LINE WITH RECENT SURVEYS WHICH INDICATE A DECLINE OF INVESTMENT INTENTIONS BY UK INDUSTRY (SEE REF A). NEWLY RELEASED GOVERNMENT STATISTICS ALSO INDICATE THAT THE RESTRICTIVE EFFECTS OF THE MINI-BUDGET OF DECEMBER AND THE MAXI-BUDGET OF MARCH ARE SERIOUSLY REDUCING DEMAND THROUGH IMPACT ON CONSUMER SPENDING AND INVESTMENT INTENTIONS. INVENTORIES WERE APPARENTLY NOT SO DEPLETED BY THE THREE-DAY WEEK AS HAD BEEN THOUGHT. THUS INVENTORY ACCUMULATION MAY NOT BE A STRONG FACTOR IN MAINTAINING DEMAND THE REMAINDER OF 1974 AND IN 1975, WHILE REDUCED INVESTMENT MAY ALSO REDUCE DEMAND LATE THIS YEAR

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AND IN 1975. THIS LEAVES ONLY EXPORTS WHICH APPEAR TO BE BOOMING TO LEAD UK ECONOMIC GROWTH FOR BOTH THE SECOND HALF OF 1974 AND 1975.

3. CONSUMER DURABLES APPEAR TO HAVE BEEN HIT HARD BY THE TIGHTER RETAIL CREDIT (HIRE PURCHASE RULES INTRODUCED IN THE MINI-BUDGET IN DECEMBER AND REDUCED REAL CONSUMER INCOME, IN PART CAUSED BY THE MARCH MAXI-BUDGET INCREASES IN

INDIRECT TAXES AND NATIONALIZED INDUSTRY PRICES (MANY STILL TO BE RAISED), AS WELL AS THE DIRECT TAX INCREASES. RETAIL SALES DROPPED BY ABOUT 2 PERCENT IN APRIL FROM THE FIRST QUARTER AVERAGE AND BY ABOUT 1.3 PERCENT IN MAY.

4. COMMENT: CRITICAL ELEMENTS IN DOMESTIC ECONOMIC SITUATION INCLUDE FIXED INVESTMENT AND INVENTORIES. AT THE BEGINNING OF 1974, SURVEYS INDICATED A 12 - 14 PERCENT PLANNED INCREASE IN INDUSTRIAL FIXED INVESTMENT FOR THIS YEAR. RECENT SURVEYS NOW INDICATE AN INCREASE OF 5 PERCENT, AND BUSINESS CONFIDENCE, AS WELL AS PROFITS, ARE

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INFO OCT-01 ISO-00 SAJ-01 AID-20 CIAE-00 COME-00 EB-11

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STILL DECLINING. PROFITS, IN A DOWNWARD TREND SINCE THE

LATE 1960'S, ARE BEING SQUEEZED HARD BY THE PRICE RESTRAINT MECHANISM, ON ONE HAND, AND RISING MATERIAL AND LABOR COSTS ON THE OTHER HAND (ABOUT 8 MILLION WORKERS WILL REPORTEDLY RECEIVE ONE POUND TWENTY PENCE WAGE INCREASES THROUGH THE THRESHOLD CLAUSE OF THE WAGE/PRICE PROGRAM (SEE REF C). WHILE INVESTMENT ALREADY ON STREAM MAY CONTRIBUTE TO MAINTENANCE OF DEMAND THROUGHOUT MOST OF 1974, THE REDUCED INTENTIONS BODES ILL FOR 1975 IN THE ABSENCE OF SOME POLICY ACTION TO REVERSE THE TREND.

5. INVENTORIES HAD BEEN THOUGHT BADLY DEPLETED BY THE THREE-DAY POWER LIMIT CRISIS. BUT OFFICIAL FIGURES RELEASED LAST WEEK SHOWED INVENTORIES TO BE SURPRISINGLY UNCLASSIFIED

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HIGH. THUS, INVENTORY/SALES RATIOS ARE NOT SO LOW AS HAD BEEN THOUGHT AND REBUILDING INVENTORIES WILL NOT BE A MAJOR ELEMENT IN MAINTAINING THE STRENGTH OF DEMAND DURING THE REST OF THIS YEAR. (NIESR FORECAST INVENTORY ACCUMULATION OF 378 MILLION POUNDS IN THE SECOND HALF OF 1974 IN ITS MARCH FORECAST BUT ONLY 227 MILLION POUNDS IN THE LATEST FORECAST. THE OFFICIAL FORECAST OF THE UK TREASURY ISSUED WITH THE MARCH BUDGET FORECAST 750 MILLION POUNDS INVENTORY ACCUMULATION IN THE SECOND HALF OF THIS YEAR (SEE REF B).

6. NIESR (AMONG MANY OTHERS) CONCLUDES THAT A REFLATIONARY SECOND BUDGET WILL BE NECESSARY TO PREVENT STAGNANT GROWTH AND A RISE IN UNEMPLOYMENT. TO COUNTER THE INFLATIONARY CONSEQUENCES OF SUCH A BUDGET, NIESR ADVOCATES WAGE INDEXATION, WITH NO REAL INCREASE IN WAGES FOR TWO YEARS. LINKING WAGES TO THE PRICE INDEX WOULD--AND NIESR ASSUMES NO RISE IN COMMODITY PRICES AND STABLE TERMS OF TRADE--HELP BRING THE RATE OF PRICE INCREASE DOWN TO 5 PERCENT BY 1976.

7. NIESR, IN CALLING FOR AN INDEXED WAGE SCHEME, IS BANKING ON WORLD COMMODITY PRICE LEVELS REMAINING STABLE, THE SAME ASSUMPTION THAT THE CONSERVATIVE GOVERNMENT TOOK WHEN IT INTRODUCED ITS STAGE 3 WAGE/PRICE CONTROLS WITH ITS NOW MUCH-REGRETTED "THRESHOLD" CLAUSE. AS ANTHONY HARRIS IN THE FINANCIAL TIMES OF JUNE 10 POINTS OUT, IF COMMODITY PRICES CONTINUE TO INCREASE RAPIDLY, HOWEVER, THIS COULD FEED BACK THROUGH PRICES TO EXCHANGE RATE DEPRECIATION TO WAGES TO PRICES IN AN INCREASING SPIRAL. THE CONSERVATIVES LOST THE GAMBLE; WHETHER THE TIME IS NOW MORE PROPITIOUS IS NOT ENTIRELY CLEAR. WHAT MAY BE CLEARER IS THE POLITICAL IMPRACTICABILITY OF ANY RIGID LINK TO A PRICE INDEX FOR WAGES. THE STRAINS OF THE PRESENT "SOCIAL COMPACT" BETWEEN LABOR AND THE LABOUR GOVERNMENT

ARE ALREADY BEGINNING TO SHOW. UNION WAGE DEMANDS ARE ACCELERATING AND MANY OBSERVERS FORESEE A WAGE EXPLOSION IN THE AUTUMN AFTER THE NEXT GENERAL ELECTION (SEE REF D). IT SEEMS UNLIKELY THAT THE GOVERNMENT WOULD DECIDE TO PREVENT THIS THROUGH AN INDEXED WAGE FREEZE AS IT WOULD OPEN DEEP RIFTS IN THE LABOUR PARTY. MOREOVER, AT THE SAME
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TIME, INCREASED UNEMPLOYMENT APPEARS A CERTAINTY. THERE WILL BE INCREASED CALLS FOR A REFLATIONARY AUTUMN BUDGET. BUT IF IT WERE TO STIMULATE CONSUMER DEMAND, REDUCING EXPORTS AND INCREASING IMPORTS, IT WOULD DIVERT THE GOVERNMENT FROM ITS "EXPORT-LED GROWTH" COURSE. ON THE OTHER HAND, THE GOVERNMENT COULD TRY TO STIMULATE DEMAND THROUGH RESTORING BUSINESS CONFIDENCE AND INDUCING INCREASED INVESTMENT. IT WOULD REQUIRE PUTTING A MUZZLE ON THE MANY LABOUR PARTY SPOKESMEN CALLING FOR INCREASED GOVERNMENT PARTICIPATION AND/OR NATIONALIZATION TO RESTORE BUSINESS CONFIDENCE TO ANY DEGREE. AS TO MEASURES TO INDUCE INVESTMENT, THESE ALREADY EXIST ON THE FISCAL SIDE (I.E. TAX INCENTIVES); THE ONLY POLICY AREA IS IN LEAVING OR LIFTING THE PRICE/PROFIT CONTROLS AND THE NEED FOR THIS MIGHT PREVENT ANY STRONG GOVERNMENT ACTION TO LIMIT WAGE INCREASES.

8. DETAILS OF THE NIESR FORECAST WILL FOLLOW BY AIRGRAM.

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